United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

DOCKET NO. 74-1697

SIRBO HOLDINGS, INC.,

PETITIONER, APPELLANT,

v.

COMMISSIONER OF INTERNAL REVENUE,

RESPONDENT, APPELLEE.

APPELLANT'S BRIEF

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Is the taxpayer-lessor (Sirbo) entitled to treat as long-term capital gain a single payment of $125,000 received in 1964 from its tenant (Columbia Broadcasting System) for agreed upon damages to the leased premises attributable to the tenant's prior occupancy between 1947 and 1963?

STATEMENT OF THE CASE

This is an appeal from a SUPPLEMENTAL OPINION and decision of the United States Tax Court (61 T.C. No. 77), dated

March 13, 1974, again redetermining a deficiency in corporate income tax of Sirbo Holdings, Inc. in the amount of $53,573.30 for its fiscal year ended June 30, 1964. (S. R. 130-140)*. This case was previously before this Court of Appeals; on March 23, 1973, it reversed an earlier Tax Court opinion and decision and remanded for reconsideration. (S. R. 5-19) Sirbo Holdings, Inc. v. Commissioner of Internal Revenue, 476 F.2d 981 (C.A. 2, 1973), rev'g 57 T.C. 530.

In its prior opinion reversing the Tax Court, the Court of Appeals concluded Sirbo had not proved that $125,000 paid by Sirbo's lessee, Columbia Broadcasting System (hereinafter CBS), represented an "involuntary conversion", within the meaning of Section 1231, IRC of 1954, of some of Sirbo's property leased to CBS. (S. R. 11-13)

The Court of Appeals, however, reversed in part because of the Tax Court's failure to consider in depth whether the transaction

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*Page references preceded by "S.R." refer to pages of APPELLANT'S SUPPLEMENTAL RECORD APPENDIX, which includes all relevant documents in this case beginning with and subsequent to the prior Court of Appeals opinion (476 F.2d 981). Page references preceded by "R." alone refer to pages of APPELLANT'S APPENDIX, in Docket No. 72-1617, constituting the original record before the Court of Appeals on which its prior opinion was based.

might nevertheless qualify as a "sale or exchange" within the meaning of Section 1231. (S. R. 14-19)

The Court of Appeals noted the heavy reliance that the Tax Court had previously placed on "dicta" in Billy Rose's Diamond Horseshoe, Inc. v. United States, 448 F.2d 549, 551-52 (2 Cir.) aff'g 322 F. Supp. 76 (S.D.N.Y. 1971). (S. R. 14) The Court of Appeals further suggested to the Tax Court that the meaning of "sale" in the installment sale provision (Sec. 453), involved in the Billy Rose case, might well be more "restrictive" than the meaning of "sale or exchange" in Section 1231, involved in the instant case. (S. R. 17-18)

Finally, the Court of Appeals noted three separate and unresolved conflicts.

First, it noted a conflict in the Commissioner's own positions: the Commissioner had conceded a similarly situated taxpayer's right to capital gain treatment in a case decided two months after the instant case. (S. R. 15) Boston Fish Market Corp., 57 T.C. 884.

Secondly, it noted a conflict between language used by the Tax Court in the Boston Fish Market Corp. case, and the result reached by

The Tax Court in the instant case. (S. R. 16)

Thirdly, it noted a conflict in opinions of the Second Circuit, stating (S.R. 18):

> "The basic inconsistency in approach between Ferrer and Billy Rose has already attracted comment, see 14 B.C. Ind. & Comm. L. Rev. 183 (1972). It may be that en banc proceedings will be needed to resolve this. However, even though the question is one of law, this court, before going down that path, should have the benefit of the considered views of the Tax Court, hopefully the full Court, IRC, Section 7460(b), on whether it would follow Boston Fish Market on the facts here, if it deemed itself free to do so, as we think it is."

Since the Court of Appeals said that the Tax Court should require the Commissioner to "explain and justify" (S. R. 19, footnote 10) his different positions in Boston Fish Market and the instant case, the parties thereafter stipulated as part of the record in this case the Commissioner's briefs and the record in Boston Fish Market. (S. R. 20-64)

The Commissioner's briefs in the Boston Fish Market case reflect one persistent argument confidently and successfully advanced by him (diametrically opposed to his position in the instant case): the Commissioner successfully argued in Boston Fish Market that when a lessee removes or modifies parts of leased premises for the lessee's convenience, the lessor has in effect "sold in pieces";

and any amount paid thereafter by the lessee in lieu of restoring the premises to their pre-lease condition are "taxable as long term capital gain in the year of receipt". (S. R. 26, 31, 33, 34, 39-43, 45, 60, 61)

In the brief that he subsequently filed with the Tax Court in the instant case, to "explain and justify" his different positions in Boston Fish Market and the instant case, the Commissioner's only "explanation" and "justification" was that the position he had taken in Boston Fish Market was "erroneous". (S. R. 66, 81, 85) Although the Commissioner's brief mentioned two "factors" allegedly different in the two cases, the brief candidly stated "it has been determined that the foregoing factors do not provide a sufficient distinction between these two cases". (S. R. 86) The Commissioner's brief then proceeded to argue: (1) that no "sale" had occurred here because when Sirbo received $125,000 from CBS "no property passed to CBS" (S. R. 88, 89, 95); and (2) since the Billy Rose case had decided that a similar transaction was not a "sale or other disposition" within the meaning of Section 453, the transaction in issue here was also not a "sale or exchange" within the meaning of Section 1231 (S. R. 107-109). The Commissioner concluded his new brief by stating "this [Tax] Court's prior decision herein was correctly predicated upon the Second Circuit's decision in Billy Rose's Diamond Horseshoe and such decision should accordingly be

re-affirmed." (S. R. 112)

Sirbo filed a reply brief with the Tax Court, arguing in part** that the Commissioner had failed to "explain and justify" his different positions, as the Court of Appeals had ordered (S. R. 114-117); that the Commissioner had a duty to treat similarly situated taxpayers equally, which duty was breached in the instant case (S. R. 117-121); and that characterizing the $125,000 as payment for "updating" the lease restoration clause was not inconsistent with Sirbo's right to capital gain treatment. (S. R. 123-129)

The Tax Court in a SUPPLEMENTAL OPINION (61 T.C. No. 77) filed March 13, 1974, concluded: (1) that "sale or exchange" in Section 1231 of the 1954 Internal Revenue Code had the same narrow meaning that the Supreme Court in its 1941 Flaccus opinion (Helvering v. Flaccus Leather Co., 313 U.S. 247) had accorded "sale or exchange" in interpreting a provision of the Revenue Act of 1934 (S. R. 132-135); (2) "we must profess our inability to distinguish

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**Sirbo's brief filed with the Tax Court also extensively discussed the legislative history and historically limited meaning of "sale" in the installment sale provision (Sec. 453) and the nonapplicability of such limitations in interpreting Sec. 1231.

in principle between our opinion in this case and the opinion of the appellate court in Billy Rose's Diamond Horseshoe, Inc. v. United States, 448 F.2d 549 (C.A. 2, 1971), with which we are in full agreement" (S. R. 138); (3) the Billy Rose decision is "compatible" with Commissioner v. Ferrer, 304 F.2d 125 (C.A. 2, 1962) (S. R. 138, 139); and (4) nothing was "sold" in the instant case because "nothing passed between the parties except the sum of $125,000 paid to the petitioner by CBS". (S. R. 139)

After the Tax Court on March 15, 1974 entered its decision sustaining the Commissioner's determination of a deficiency of $53,573.30 in Sirbo's income tax for its taxable year ended June 30, 1964, Sirbo on April 29, 1974, filed a timely notice of appeal to the Court of Appeals for the Second Circuit. (S. R. 4, 140, 141)

ARGUMENT

I

The Tax Court failed to explore the issue raised by the prior opinion of this Court of Appeals: whether the installment sale language of Section 453 has a more "restrictive" meaning than the language of Section 1231.

In its previous opinion reversing the Tax Court, this Court of Appeals squarely raised the question whether "sale or other disposition" in Section 453 has a more restrictive meaning than "sale or exchange" in Section 1231. The opinion of the Court of Appeals stated (476 F.2d at page 988):

> "The Tax Court's failure to reconcile its decision here with that in Boston Fish Market, cf. IRC §7460(b), may have rested, although this is only speculation, upon a belief that, under its ruling in Jack E. Golsen, 54 T.C. 742, 756-58 (1970), it was bound in this case by the dicta in Billy Rose, supra, 448 F.2d 549. We say dicta because, as indicated, the issue in that case was not whether the transaction came within the I.R.C. §1231 but whether a series of payments like the single payment here in question constituted income from 'a sale or other disposition of real property' or 'a casual sale or other casual disposition of personal property' so as to qualify for treatment as an installment sale under I.R.C. §453(b). In view of the background of the installment sale provisions, which are to be strictly construed, see 2 Mertens, Law of Federal Income Taxation, §15.01 (1967); see, e.g., Harry Leland Barnsley, 31 T.C. 1260, 1263 (1959), one could conclude that the transaction in Billy Rose was not a 'sale or other disposition of real property' for purposes of §453(b) without deciding whether the income it generated should be treated as capital gains or ordinary income under §1231--an issue which the taxpayer in that case did not raise. The case law offers examples of transactions allowed installment treatment under §453(b)(1)(A) which were

> treated successively as capital gains and as ordinary income when the tax law changed before an installment obligation matured. See Murray v. United States, 192 Ct. Cl. 63, 426 F.2d 376, 381 (1970) ('The function of section 453 is one of timing, not characterization. [U]se of the installment method defers the reporting of taxable gain, but in no way characterizes the nature of the gain.') See also Snell v. C.I.R., 97 F.2d 891 (5 Cir. 1938); Zola Klein, 42 T.C. 1000 (1964); 2 Mertens, supra, §15.11.[1] Furthermore, the committee reports on §212(d) of the Revenue Act of 1926, 44 Stat. 23, which purported to 'define the situations and business to which such [installment] basis might be applied,' neither made explicit reference to characterization as capital gains nor referred solely to classes of transactions which today would demand capital gains treatment. H.R. Rep. No. 1, 69th Cong., 1st Sess. (1926), reprinted in Cum. Bull. 1939-1 part 2 at 346-47. In view of the different purposes of the two provisions, Congress might well be thought to have intended a more restrictive meaning for 'sale or other disposition' in §453(b) than for 'sale or exchange' in §1231(a)."

Instead of exploring this issue, the Tax Court on remand simply assumed, without discussion or analysis, that the language of Section 453 is at least as broad as that of Section 1231. The Tax Court opinion states (R. 137, 138):

> "Notwithstanding the opinion of the appellate court remanding this case to us for consideration, we must profess our inability to distinguish in principle between our opinion in this case and the opinion of the appellate court in Billy Rose's Diamond Horseshoe, Inc. v. United States, 448 F. 2d 549 (C.A. 2, 1971), with which we are in full agreement. The term

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[1]See also Realty Loan Corporation, 54 T.C. 1083 (1970).

> "sale or other disposition" in section 453 encompasses both the 'sale or exchange' and the 'compulsory or involuntary conversion' in section 1231.[2] A transaction which was not a 'sale or other disposition' under section 453, a fortiori, would not constitute a 'sale or exchange' under section 1231."

The error in the Tax Court opinion is the assumption that "sale or other disposition" in Section 453 is all-encompassing, being the equivalent of "sale or any other disposition".

II

The term "sale or other disposition" in the installment sale provision (Sec. 453) has an historically "restrictive" meaning.

Despite a deceptive surface appearance of broad applicability, "sale or other disposition" in Section 453 has a traditionally limited meaning. In that special setting the seemingly broad reference to "other disposition" has been interpreted as qualified, or limited, by the antecedent word "sale".

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[2] In some other context (e.g., Section 1001(a)), "sale or other disposition" would, at least on a cursory reading, be entitled to such an all-encompassing meaning; but its meaning in Section 453 does not lend itself to any cursory reading because in that context it is colored by prior restrictive interpretation, more fully discussed later in this brief. See in this connection Note, "The Elements of a Section 117 'Sale or Exchange'". 53 Col. L.R. at pages 976, 977; see also footnote 5 at page 17 of this brief.

"Sale" in Section 453 means proceeds of a conventional "contract of sale" under which, notwithstanding an immediate transfer of title, a part of the selling price remains to be paid, the income element to be reported proportionally as received if the seller has made a proper "election" to use the installment method. "Other disposition" in Section 453 is limited to proceeds of a conventional "contract to sell" providing for a future, rather than an immediate, transfer of title, but again a part of the selling price remains to be paid, the income element to be reported proportionally as received if the seller has made a proper "election" to use the installment method.

Relevant parts of Section 453 are hereinafter set out:

"SEC. 453. INSTALLMENT METHOD.

(a) Dealers in Personal Property.--

(1) In general.--Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) Total contract price.-- For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan or with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1).

(b) Sales of Realty and Casual Sales of Personalty.--

(1) General rule.--Income from--

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) Limitation.--Paragraph (1) shall apply--

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition--

(i) there are no payments, or

(ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

* * *

(e) Carrying Charges Not Included in Total Contract Price.--If the carrying charges or interest with respect to sales of personal property, the income from which is returned under subsection (a)(1), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest. This subsection shall not apply with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in subsection (a)(1)."

(Emphasis supplied)

The essentiality of a "contract to sell", or "contract of sale", to qualify for the installment method, is thus indicated by the repeated references in Section 453(a)(1), and Section 453(a)(2), and Section 453(e), to "total contract price", as well as by the reference in Section 453(a)(2) and Section 453(b)(2) to the "selling price", obviously the price reflected by the "sales" or "selling" contract.[3]

This requirement of a "total contract price" has been a fixture of the installment privilege for more than half a century. Blum's Incorporated, 7 B.T.A. 737, 757 (1927). That case at pp. 751-757 sets out the legislative history of the privilege; see also Willcuts v. Gradwohl, 58 F.2d 587, 589-592 (C.C.A. 8, 1932). The earliest Committee reports, beginning in 1926, just assume that use of this installment method is confined to proceeds of a conventional "sales" or "selling" contract. H. Rep. No. 1, 69th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 315, 346, 347); H. Rep. No. 356, 69th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 361, 363).

Further confirmation of the essentiality to enjoyment of the installment privilege of a "contract of sale" or a "contract to sell", is the language of Section 1001(d):

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[3]There is no comparable language in Section 1231 emphasizing "contract price" and "selling price".

"Installment Sales.--Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received."

The history of this installment sale privilege, at first in 1918 provided for by regulations, and later in 1926 made statutory, supports this interpretation, viz., that the privilege has to date been judicially restricted to proceeds of a conventional "contract to sell", and the proceeds of a conventional "contract of sale". That history shows the installment sale privilege was originally limited to proceeds of a "contract to sell", and only later expanded to include proceeds of a "contract of sale". The following is from 2 Mertens, Law of Federal Income Taxation, Section 15.02 (Ch. 15, pp. 4, 5):

"§15.02. Historical Development of Installment Provisions Prior to the 1954 Code. The installment basis of reporting income was first recognized by Articles 116 and 117 of Regulations 33 (Revised) in 1918. These Regulations distinguished between contracts of sale and contracts to sell. In the former case it was provided that the gain was to be returned as income for the year in which the sale was made. Forfeiture of the contract or failure to meet any of the payments resulted in a deductible loss to the seller. In the case of contracts to sell where title remained in the vendor, the income to be returned by the vendor was that proportion of each installment payment which the gross profit to be realized bore to the

gross contract price."

* * * *

"In 1919, Article 42 of Regulations 45 contained a much more detailed provision for the reporting of installment sales. This provision established a uniform rule for the reporting of income from installment sales no matter which one of four methods the dealer adopted for protecting himself in case of default. The rule prescribed was that in a sale or contract of sale of personal property on the installment plan, whether or not title remained in the vendor until the property was fully paid for, the income to be returned by the vendor was that portion of each installment payment which the gross profit to be realized bore to the gross contract price. This general method for the reporting of income from installment sales has been continued down to the present time." (Emphasis supplied.)

In Charles J. Derbes, 24 B.T.A. 276, 283 (1931), aff'd 69 F.2d 788 (C.C.A. 5, 1934) the Board of Tax Appeals held that "title must pass eventually in order to have a sale or other disposition" within the meaning of this installment sale provision. 24 B.T.A. 276, at page 283. The Derbes case held that payments received under a contract to sell (title was yet to pass) were reportable under the installment method as well as payments received under a contract of sale (title passed immediately).[4]

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[4]This Derbes case, it should be noted, was decided in 1931, some eleven years before what is now Section 1231 of the 1954 Code (formerly Section 117(j), IRC of 1939), was enacted in 1942.

In Harry Leland Barnsley, 31 T.C. 1260 (1959), a lessor of oil and gas property sought, unsuccessfully, to extend installment reporting to a receipt of promissory notes as part of an advance royalty from his lessee. The Tax Court, relying on Derbes, held again that installment sale reporting applies only to transactions where pursuant to a presumably conventional selling contract a "seller" has made a transfer of title to a payor, or is obligated ultimately to make such a transfer. In that case the Tax Court stated (31 T.C. at page 1263):

> "Petitioner, however, argues that this was an installment 'sale or other disposition' of personalty or real estate under Section 44(b), and that he is thus permitted to report his receipts on the installment basis. As pointed out above, we think that Burnet v. Harmel effectively disposes of his argument insofar as a 'sale' is concerned. Under that case the transaction was not a sale. Neither do we think it was any 'other disposition' of personalty or real estate. To us the term 'other disposition' is qualified by its antecedent 'sale', and thus has reference to that type of transaction which, when finally completed, will result in a disposition of title to property, though it may, at the time of its consideration for tax purposes, be something less than a completed sale. See Charles J. Derbes, 24 B.T.A. 276, aff'd. (C.A. 5) 69 F.2d 788. We do not think this transaction was such a disposition." (Emphasis supplied.)

Also supporting this interpretation is the following excerpt from 2 Mertens, supra, Sec. 15.08 (Ch. 15, pp. 24, 25):

"The fact that title does not pass when the initial payments are made does not prevent a transaction from being taxed as an installment sale; while under local law it may not constitute a sale, it is nevertheless a 'disposition' and therefore satisfies the statute. It is enough that the contract obligated the seller to execute and deliver a deed of conveyance in subsequent years; that it obligated the purchaser to make the payments during the subsequent years; that it vested the purchaser with the right of possession; that the cash payment made during the taxable year did not exceed thirty percent of the selling price; and that the taxpayer elected to treat the transaction as a sale on the installment basis. Before there is a 'disposition' within the meaning of the Code the agreement between the parties must have created an unconditional obligation to sell and an unconditional obligation to buy. This involves a question of state law. While 'sale or other disposition' is the statutory language appearing in the installment method section, the phrase 'other disposition' has reference to a transaction which will result in a disposition of title to property, and an oil lease accordingly is not a 'disposition' and the installment method may not be used in reporting the proceeds received from such a lease." (Emphasis supplied.)[5]

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[5]This excerpt from Mertens with its emphasis on "title disposition" to qualify for the installment privilege points up the error of the Tax Court's statement (S.R. 138) that: "The term 'sale or other disposition' in Section 453 encompasses both the 'sale or exchange' and the 'compulsory or involuntary conversion' in Section 1231." The latter type of conversion specifically includes "theft". But there is no disposition of title in a "theft". Arguably, based on the decided cases interpreting the installment sales language, proceeds of a "theft" (e.g., an insurance recovery therefrom) would never fall within the scope of Section 453, whereas they would clearly fall within Section 1231. In short, contrary to the Tax Court's position, Section 1231 has a broader coverage than Section 453, at least as Section 453 has to date been judicially interpreted.

It is this restrictive interpretation of "sale or other disposition" in Section 453, necessitating either an immediate or a future "disposition of title" pursuant to a conventional "contract of sale" or "contract to sell" that accounts for the result in Billy Rose. This becomes clear from the District Court opinion in that case, 322 F.Supp. 76 (D.S.D., N.Y. 1971), where Judge Ryan stated:

322 F.Supp., at page 79

> "I conclude that, whether the transaction is a compromise, satisfaction or a release, it does not qualify as a 'sale', or 'other casual disposition' within the meaning of the installment sales provisions, and that plaintiff is not entitled to elect that method of reporting this income."

322 F.Supp., at page 80

> "The term 'other disposition' in the installment sales provisions is of no help to plaintiff because it is qualified by its antecedent 'sale'. Harry Leland Barnsley, 31 T.C. 1260, 1263 (1959) The phrase 'other disposition' has reference to a transaction which, when finally completed, will result in a disposition of title to property, though it may at the time of its consideration for tax purposes, be something less than a completed sale. The transaction involved here was not a 'sale', nor was it a 'disposition' of property within the statute." (Emphasis supplied.)

By way of summary, in Billy Rose (as in the instant factually similar case) there was no conventional "contract of sale", contemporaneous with payment to the lessor, providing for some pres-

ent immediate transfer of title by the lessor, and there was no conventional "contract to sell", contemporaneous with payment to the lessor, providing for some future transfer of title by the lessor.[6] Based on prior decided cases restricting the installment reporting privilege to those two situations, the installment method was held not applicable in Billy Rose to proceeds received by the lessor in that case. The lessor's right to use the installment reporting privilege, under restrictively interpreted Section 453, was the only issue decided by Billy Rose. In its opinion in that case the Court of Appeals stated (448 F.2d, at page 551):

> "The sole issue presented is whether taxpayer may elect to use the special relief provisions of Sec. 453 of the Internal Revenue Code of 1954 and thus postpone tax on the three notes until they are paid or whether the notes are income in the year received in accordance with the general rules of taxation."
>
> * * *
>
> "The transaction involved here was not a 'sale or other disposition of personal property' as those terms are used in Section 453." (Underscoring supplied.)

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[6] As this brief later argues, the "sale or exchange" that took place in the instant case occurred prior to any agreement on the amount to be paid by CBS, the lessee, that is when CBS in earlier years had appropriated the lessor Sirbo's fixtures, etc. to its own purposes. Cf. Central Tablet Manufacturing Co. v. United States (No. 73-593), _____ U.S. _____, 42 L.W. 4961 (1974), decided June 19, 1974, after the Tax Court had rendered its opinion in the instant case on March 13.

III

The traditionally limited meaning, and scope, of the installment sale provision (Section 453) has no bearing on the interpretation of Section 1231, which was enacted much later and without reference to Section 453.

The instant case has to do with Sirbo's right to capital gain treatment, under Section 1231, for a payment received in one year. There is thus no issue of any right to use the installment method of reporting income under Section 453, the only issue raised by the Billy Rose case. The District Court opinion in Billy Rose indicates the two issues are not the same (322 F.Supp. at pages 81, 82):

> "The Second Circuit Court of Appeals in Ferrer held that capital gains treatment will turn directly on the character of the asset regardless of the nature of the disposition (especially where, under the facts, it is found that there is 'no sensible business basis' for distinguishing between a hypothetical sale and the disposition (a release) which actually took place). In sum, in capital gains cases, the focus in the Second Circuit has been on the type of property, not the nature of the disposition. However, in the instant case [Billy Rose] the focus is on the nature of the disposition (i.e., whether it was a 'sale' for the purposes of installment sales provisions), and the General Artists and Starr Bros. cases still speak with authority to that question irrespective of what the holding may be when the question of capital gains treatment is raised."
>
> "...I conclude that plaintiff [Billy Rose] is not entitled to relief of the installment sales provisions." (Emphasis supplied.)

The Congress that in 1942 added Section 117(j) to the Internal Revenue Code of 1939, did not intend to carry over and make necessary to its application the presence of a conventional "contract of sale" or "contract to sell", which traditionally, since 1926, have been essential to use of the installment sale privilege.[7] The expressions "total contract price" and "selling price" that occupy so central a position in the installment sale provision (now Section 453) were not duplicated in enacting Section 117(j) of the 1939 Code, now Section 1231 of the 1954 Code. Moreover, the Committee reports explaining Section 117(j) do not even refer to the installment sale provision, statutorily enacted sixteen (16) years earlier in 1926, as furnishing some guideline to, or limitation upon, the meaning and scope of what is now Section 1231 of the 1954 Code.[8]

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[7]The earliest Committee reports, beginning in 1926, that deal with the installment sale privilege, just assume that use of this privilege is confined to proceeds of a "selling contract". H. Rep. No. 1, 69th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 315, 346, 347); H. Rep. No. 356, 69th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 361, 363).

[8]These 1942 Committee Reports explanatory of what is now Section 1231 are found in H. Rep. No. 2333, 77th Cong., 1st Sess., (1942-2 Cum. Bull. 372, 415, 445, 446); S. Rep. No. 1631, 77th Cong. 2nd Sess. (1942-2 Cum. Bull. 504, 545, 594); and Conference Committee Report, H. Rep. No. 2586, 77th Cong., 2nd Sess. (1942-2 Cum. Bull. 701, 708, 709).

Section 117(j) of the Internal Revenue Code of 1939 was enacted because of congressional disapproval of a prior narrow construction of the term "sale or exchange" by the Supreme Court. The Supreme Court acknowledged as much in Commissioner v. Gillette Motor Transport, Inc., 364 U.S. 130 (1960), at page 134:

> "Section 117(j), added by the Revenue Act of 1942, effects no change in the nature of a capital asset. It accomplishes only two main objectives. First, it extends capital-gains treatment to real and depreciable personal property used in the trade or business, the type of property involved in this case. Second, it accords such treatment to involuntary conversions of both capital assets, strictly defined, and property used in the trade or business..."
>
> * * * *
>
> ...."The second change was apparently required by the fact that this Court had given a narrow construction to the term 'sale or exchange'. See Helvering v. Flaccus Leather Co., 313 U.S. 247."

The Internal Revenue Service and the Tax Court, in the instant case, are apparently seeking to establish again a repudiated narrow construction of "sale or exchange", by reading into Section 1231 a limitation drawn from the quite different and unrelated language and history of Section 453.[8a]

[8a] The two sections also operate on different assets. Section 453(a) indicates an intention to apply the installment privilege to inventory-type assets recurrently sold; Section 1231(b)(1) excludes such assets.

IV

The Flaccus case did not hold that there is one changeless meaning for the term "sale or exchange" in the Internal Revenue Code.

The Flaccus case did not hold that there is one changeless definition of the word "sale" wherever it appears in the Internal Revenue Code. The Supreme Court there said (313 U.S. at page 249):

> "Generally speaking, the language in the Revenue Act, just as in any statute, is to be given its ordinary meaning, and the words 'sale' and 'exchange are not to be read any differently. Compare Helvering v. Hammel, 311 U.S. 504, 61 S. Ct. 368, 85 L. Ed. _____, 131 A.L.R. 1481; Fairbanks v. United States, 306 U.S. 436, 59 S. Ct. 607, 83 L.Ed. 855; Burnet v. Harmel, 287 U.S. 103, 53 S. Ct. 74, 77 L.Ed. 199. Neither term is appropriate to characterize the demolition of property and subsequent compensation for its loss by an insurance company. Plainly that pair of events was not a sale. Nor can they be regarded as an exchange, for 'exchange', as used in Section 117(d), implies reciprocal transfers of capital assets, not a single transfer to compensate for the destruction of the transferee's asset." (Emphasis supplied.)

The very first case that the Supreme Court cites, in this excerpt, shows that in Flaccus it was not endorsing the concept of one changeless definition of the word "sale" wherever it appears in the Internal Revenue Code. In Helvering v. Hammel, 311 U.S. at page 507 , the Supreme Court had stated:

> ". . .The term sale may have many meanings depending on the context, see Webster's New International Dictionary. The meaning here depends on the purpose with which it is used in the statute and the legislative history of that use."

As the Supreme Court itself subsequently recognized in Commissioner v. Gillette Motor Transport, Inc., supra, what is today Section 1231 was enacted to overcome a "narrow construction" that the Supreme Court in Flaccus had given to "sale or exchange" in a prior revenue law.

V

In any event, the instant case is readily distinguishable from Flaccus.

In Flaccus no transfer of property had been made at any time, by the recipient of insurance proceeds, to the payor, the insurance company. Thus, it is understandable that, in interpreting the Revenue Act of 1934, the Supreme Court would hold, on such facts, there had been no "sale". A transfer of property of some kind to the payor has been regarded[8b] as an essential element of a "sale or exchange". See Note, "The Elements of a Section 117 Sale or Exchange", 53 Col. L. R. 976 (1953), at pp. 978, 984-986, 990.

[8b] Prior to Central Tablet, supra.

In the instant case, however, there was indeed a transfer of property and therefore a "sale" by Sirbo to CBS, whenever CBS over the years appropriated some of Sirbo's fixtures, etc. to CBS's own purposes. Certainly the Commissioner will not argue that this is some strange misuse of the word "sale".[8c] The Commissioner himself successfully pressed on the Tax Court such a meaning for "sale" in Boston Fish Market Corporation, Fulham and Maloney, Inc., 57 T.C. 884 (1972). The Commissioner's briefs in that case have been stipulated as part of the record in the instant case. There we find the Commissioner stating the question in that case to be (S. R. 25, 26, 31):

> "Whether the sum of $47,500.00, received by the petitioners in 1968 from a tenant in satisfaction of the tenant's obligation to restore the leased premises to their pre-lease condition, constituted long-term capital gain to the petitioners reportable in 1968."

Thereafter the Commissioner went on to argue that the lessor in that case had "sold in pieces". (S. R. 39-44)

> "When petitioners accepted the sum of $47,500.00 from First National Stores in lieu of having certain fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators and individual refrigerator chests or rooms restored, petitioners, in effect, sold these assets.
>
> Inasmuch as petitioners failed to establish any basis for the assets which were to have been

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[8c] Nor can the Tax Court; see page 31 of this brief.

restored, the entire $47,500.00 is taxable as long-term capital gain."

* * *

"Petitioners' reliance on Hamilton & Main, Inc., 25 T.C. 878 (1956) is also misplaced. That case stands for the proposition that where an asset is purchased for a lump sum and is sold in pieces and the taxpayer shows that there is no way to apportion basis to each piece, the taxpayer may recover his entire lump sum basis before realizing any gain upon the sale of the pieces. In the instant case, in the nomenclature of the Hamilton & Main, Inc. case, assets were acquired in pieces, between 1913 and 1964, and not in a lump sum. Consequently, the case is inapplicable. In effect, what petitioners have done in the instant case is sell assets acquired on or before September 25, 1947 and on or before December 22, 1953. In an attempt to avoid taxation on the sales proceeds, petitioners reduced the basis of assets acquired after 1956. This is not permissible under the Hamilton & Main, Inc. case or any other authority."

* * *

"It is respondent's [the Commissioner's] position that petitioners, in effect, sold the assets which the tenant was obligated to restore and because petitioners cannot establish any unrecovered basis for the assets, the entire sales proceeds of $47,500.00 are taxable in 1968, the year of receipt."

* * *

"In the instant case we are not concerned with the value of improvements left behind by a lessee upon the termination of a lease. We are concerned only with the proper tax treatment to be accorded the $47,500.00 in cash paid to the lessor for certain assets which the lessee was obligated to restore."

The following extract from the Note, "The Elements of a Section 117 'Sale or Exchange'", 53. Col. L. R. at page 990, indicates the necessity[8d] of a transfer of property to the payor of consideration:

> "It is evident that reference to common usage is not sufficient to determine whether a given transaction is a 'sale or exchange' within the meaning of Section 117. This is not to say that a common usage definition of these terms is valueless. A transaction which is usually called a 'sale or exchange' will be treated as one under Section 117; but the fact that a transaction is not ordinarily considered a 'sale or exchange' is not determinative of what it will be called for the purpose of capital gain and loss treatment. Thus, despite common usage, condemnation proceedings, forfeitures of land because of inability to pay, and compromises of suits have been held to be 'sales or exchanges'.
>
> "Although for the most part the courts have dealt with each category of 'sale or exchange' cases--e.g., forced sales and voluntary reconveyances--as a distinct type, analysis of all the categories indicates that there are two requirements essential to a 'sale or exchange'. First, there must be consideration. Since the taxpayer need not be the person who makes the transfer, it is not necessary that he receive the consideration. Secondly, the transaction must involve a transfer of the taxpayer's property to the payor of consideration." (Emphasis supplied.)

In Flaccus there had never been any transfer of property to the payor of consideration [the insurance company]; consequently it was held there had been no 'sale or exchange' in that case.

[8d] Prior to Central Tablet, supra.

In the instant case, as in the Boston Fish Market case, there was a prior transfer of property "in pieces" to the payor of consideration, so it is reasonable to conclude, as the Commissioner himself argued and concluded in Boston Fish Market, that there was on these facts a "sale or exchange".

The Tax Court in the instant case seems to have created and added an absolutely novel and peculiar requirement for a "sale or exchange", viz., that the seller must be found to have made a transfer of property contemporaneous with the seller's receipt of his consideration or payment. Thus the Tax Court said in its opinion on remand (S. R. 139):

> "By contrast, in the Sirbo case, nothing passed between the parties except the sum of $125,000 paid to the petitioner by CBS.[9] Nothing was sold, nothing was exchanged, and nothing reverted to CBS. In fact, as of the time of the payment--and even today--there can be no assurance that the obligation of CBS to restore under the new lease might turn out to be as burdensome as was such obligation under the original lease."

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[9] In its prior opinion this Court of Appeals picturesquely depicted the Tax Court as "taking somewhat of a keyhole view". 476 F.2d at page 987. The Tax Court here seems to be still squinting through the same "keyhole". (S. R. 14)

There has never been any such requirement for a "sale or exchange". Indeed, the recently decided Supreme Court case of Central Tablet Manufacturing Co. v. United States, (No. 73-593), _____U.S._____, 42 L.W. 4961 (1974), hereafter discussed, demonstrates (1) that there is no such requirement; and (2) the Tax Court, in relying on the Flaccus case, is relying on what is today a wholly discredited case.

VI

The Tax Court opinion has misread Flaccus as containing a "definition" of "sale or exchange" and as setting out "tests" or "standards" for determining a "sale or exchange".

The Tax Court opinion gratuitously assumes to be true what is clearly not so, viz., that in its 1941 Flaccus opinion the Supreme Court established some "definition" of "sale or exchange", and set out "tests" and "standards" for determining what is a "sale or "exchange". After quoting a brief extract from the Flaccus opinion, the Tax Court opinion states (S. R.133,134):

> "The Congress thereupon enacted section 117(j) of the Revenue Act of 1942, wherein it was specifically provided that gain realized as a result of the compulsory or involuntary conversion of property shall be treated the same as a gain from the sale or exchange of such property.

> "The amendment in question merely modified the decision in the Flaccus case as applied to a payment received as a result of the compulsory or involuntary conversion of property where the payor received nothing in exchange. In all other cases, the requirement that there be a 'sale or exchange', as defined in the Flaccus case, remained unchanged.
>
> "We find no justification in the absence of Congressional action to disregard the tests established in Flaccus Leather Co., supra, in the characterization of the transaction between the petitioner and its lessee. Measured by those standards, there was no sale or exchange of any property or property right by the petitioner." (Emphasis supplied.)

Despite assiduous rereading of Flaccus, Sirbo's counsel cannot find any "tests" or "standards" set out in that opinion for determining a "sale or exchange".

Before the recent Central Tablet case (later discussed in this brief) there were just two recognized "tests" for determining if a "sale or exchange" had occurred. There had to be (1) the receipt of consideration; and (2) a transfer of property by the recipient to the payor of the consideration. See the quotation from the Columbia Law Review article set out earlier at page 27 of this brief. These two elements were present in the instant case; see pages 25-28, inclusive, of this brief.

Moreover, this extract from the Tax Court opinion inaccurately suggests that Sirbo is asking for some strained

interpretation of the word "sale". This is not so. Both before and after Flaccus the Tax Court considered a fact situation comparable to that now under consideration, and had no perceptible intellectual difficulty in concluding that a "sale" had occurred. In Washington Fireproof Building Company, 31 B.T.A. 824 (1934), Judge Murdock in his concurring opinion stated at page 827:

> "Money was paid to a lessor by a lessee in lieu of replacing substantial parts of a building which the lessee had removed and had agreed to replace. The question is, How much of the money settlement is income to the lessor? The answer to that question does not depend upon what the lessor did with the money nor upon how much money would have been necessary to restore the building. If all or some part of the money might be considered rent that would be all income. If all or any part of the money was not rent but a payment to the lessor for portions of his building, then to that extent the transaction was substantially similar to a sale and must be treated for income tax purposes as a 'sale or other disposition' of a portion of his building."

This interpretation of "sale" was promulgated in 1934, long before Flaccus was decided in 1941, and long before Section 117(j), now Sec. 1231, came into the code in 1942 with its legislative correction of Flaccus. Then, some nine years after Flaccus, the Tax Court promulgated another opinion, again setting out approvingly Judge Murdock's language set out above. Guy L. Waggoner, 15 T.C. 496 (1950), at page 502.

VII

In relying on Flaccus, the Tax Court is relying on what is today an outmoded and wholly discredited case.

The Tax Court filed its opinion, now under review, on March 13, 1974; that opinion relies heavily on the assumed continuing vitality of the Supreme Court's 1941 Flaccus opinion.

On March 13, 1974, the Tax Court did not have the benefit of the Supreme Court's views promulgated June 19, 1974, in Central Tablet Manufacturing Co. v. United States (No. 73-593), _____U.S._____, 42 L.W. 4961. Central Tablet indicates the wheel has come full circle: what was not a "sale or exchange" at the time of Flaccus, under the Revenue Act of 1934, is today a "sale or exchange" for purposes of the Internal Revenue Code of 1954. The Flaccus holding, decided under the 1934 Revenue Act, that an "involuntary conversion" is not a "sale or exchange" is today thoroughly outmoded and discredited doctrine.

In Central Tablet (as in Flaccus) a fire destroyed a corporate taxpayer's property, and gain resulted from subsequently received insurance proceeds that exceeded the corporate taxpayer's basis for its destroyed assets. The taxpayer argued that a "sale or exchange" did not occur, under Section 337(a)(2) of the Internal

Revenue Code of 1954, until the insurance company and the taxpayer agreed on the amount to be paid the taxpayer. This became ultimately the view of the four dissenting Supreme Court judges. The government argued, and a majority of the Supreme Court concluded, that a "sale or exchange" had occurred earlier when the fire destroyed the taxpayer's property and a claim arose in favor of the taxpayer against its insurer.

The important point to be noted is that every member of the Supreme Court agreed in Central Tablet that a "sale or exchange" had taken place at some time, either when the fire destroyed the taxpayer's property (majority view) or later when the insurer agreed on the amount to be paid the taxpayer (minority view).

The following excerpts from the opinion are relevant to the present case:

42 L.W. at page 4962

> "The only issue before us is whether §337(a) has application in a situation where, as here, the involuntary conversion occasioned by the fire preceded the adoption of the plan of complete liquidation. This depends upon whether the 'sale or exchange', referred to in §337(a), took place when the fire occurred or only at some post-plan point, such as the subsequent settlement of the insurance claims, or their payment.
>
> Stated simply, it is the position of the Government that the fire was a single destructive

event that effected the conversion (and, therefore, the 'sale or exchange') prior to the adoption of the plan of liquidation, thereby rendering §337(a) inapplicable. It is the position of the taxpayer, on the other hand, that the fire was not such a single destructive event at all, but was only the initial incident in a series of events--the fire; the preparation and filing of proofs of claim; their preliminary rejection; the negotiations; ultimate dollar agreement by way of settlement; the preparation and submission of final proofs of claim; their formal acceptance; and payment--that stretched over a period of time and came to a meaningful conclusion only after the adoption of the plan, and that, consequently, §337(a) is applicable."

42 L.W. at pages 4964-4966

"Inasmuch as §337 was drafted to meet and deal with the Court Holding-Cumberland situation, where there had been a sale, the statute on its face relates only to 'the sale or exchange' of property. It is not surprising, therefore, that further confusion resulted when the Internal Revenue Service found itself confronted by liquidating corporate taxpayers who sought §337(a) treatment for casualty gains. Following the Court's decision in Helvering v. William Flaccus Oak Leather Co., 313 U.S. 247 (1941), the Internal Revenue Service at first refused to consider §337 as applicable to a casualty situation at all. Rev. Rul. 56-372, 1956-2 C.B. 187. When this was rejected in the courts, the Service reversed its position and treated an involuntary conversion that occurred after adoption of a plan of complete liquidation as a 'sale or exchange' with resulting nonrecognition, Rev. Rul. 64-100, 1964-1 C.B. (Part I) 130.

It is at this point that the issue of the instant case emerges and comes into focus. Although it is

now settled that an involuntary conversion by fire is a sale or exchange under §337(a), the question that is determinative here remains unresolved: When does the involuntary conversion by a preplan fire take place? Since the statute prescribes a strict 12-month postplan period, it is crucial for the taxpayer that the conversion be deemed to have occurred after the plan of liquidation was adopted.

* * *

"Predictably, the taxpayer analogizes the involuntary conversion to a true sale, and it argues that the conversion does not occur until settlement is reached and the insurance obligations are finally determined and paid. This essentially is the reasoning employed in the Morton case.

"There is nothing to indicate that Congress considered this problem when §337(a) was adopted. The fact that attention was invariably focused on an actual sale would indicate that the casualty situation was not legislatively anticipated. Towanda Textiles, Inc. v. United States, 149 Ct. Cl. 123, 129, 180 F. Supp. 373, 376 (1960). Recourse to legislative history, therefore, is somewhat circumstantial in nature. There is, however, one guiding fact, namely, the above-mentioned clear purpose of Congress, in its enactment of §337(a), to avoid the Court Holding-Cumberland formalities.

"The taxpayer's analogy to the ordinary sale transaction has some superficial appeal. It fails, however, to give sufficient consideration to the underlying purpose of §337(a). To be sure, under normal circumstances, a true sale is not complete until the mutual obligations (if not the precise terms) are fixed.

* * *

"With a fire loss, the obligation to pay arises upon the fire. Unlike an executory contract to sell, the casualty cannot be rescinded. Details, including even the basic question of liability may be contested, but the fundamental contractual obligation that precipitates the transformation from tangible property into a chose in action consisting of a claim for insurance proceeds is fixed by the fire. Although the parties remain free to arrive at an acceptable settlement, the obligation itself has come into being, and it is the value of the insured property at that point that governs the claim. In other words, the terms of the obligation cannot be changed unilaterally by

the insurer once the fire has occurred.

"The fact that the ultimate extent of the gain may not be known or final settlement reached until some later time does not prevent the occurrence of a 'sale or exchange' even in the context of a normal commercial transaction. See, e.g., Burnet v. Logan, 283 U.S. 404 (1931). The taxpayer's efforts to draw an analogy to a true sale is therefore of limited utility. See Note, Involuntary Conversions and §337 of the Internal Revenue Code, 31 Wash. & Lee L. Rev. 417, 427-428 (1974).

* * *

"For all practical purposes, the disposal of Central Tablet's insured property occurred at the time of its fire. At that time the taxpayer possessed all incidents of ownership. It had evidenced no intention to liquidate. The fire was irremediable. Regardless of the formalities and negotiations that prefaced the actual insurance settlements, the property was parted with at the time of its destruction.

* * *

"This interpretation is fully consistent with the manner in which condemnation, the other principal form of involuntary conversion, is treated under §337. In condemnation, the legally operative event for purposes of the statute is the passage of title under federal or state law, as the case may be, to the condemning authority. This means that in many jurisdictions the 'sale or exchange' under §337(a) occurs prior to the determination of the amount of condemnation compensation and, indeed, possibly without advance warning to the corporation owner.

* * *

"As with condemnation, the involuntary character of the fire distinguishes it from the normal sale, and, as with condemnation, for purposes of §337(a), it is irrelevant that the precise dollar amount of the insurer's obligation remains uncertain.

In the casualty situation, the owner of the insured property is deprived of aspects of ownership when the fire occurs in much the same way as the owner of condemned property is deprived at the time title passes. In each case the triggering event is involuntary and irrevocable. Because of the statutorily imposed chronology, the event operates to prevent the corporation's receiving the favorable treatment of §337(a).

* * *

"Again, although not precisely parallel and certainly not controlling, concluding the 'sale or exchange' takes place at the time of the fire is consistent with the accepted method for determining the holding period of destroyed property in the ascertainment of its long- or short-term capital gain or loss consequences. Where property is destroyed, the holding period terminates at the moment of destruction. ....Were we to accept the taxpayer's argument, we would be left with the anomalous situation of having the 'sale' take place after the holding period has terminated for capital gain or loss purposes."

Excerpt from dissenting opinion, 42 L.W. at pages 4966, 4967

"Ordinarily, gain from the sale of corporate property is taxed to the corporation. Under 26 U.S.C. §337, however, gain from a sale or exchange occurring within 12 months after the adoption of a plan of liquidation is not recognized or taxed to the corporation. Concededly, the section applies to gain from involuntary conversions such as fire losses compensated by insurance, as long as the event qualifying as the sale or exchange takes place after, rather than before, the adoption of a plan of liquidation. As the Court indicates, the sole issue in this case is when the sale or exchange occurred.

"Here, the fire took place on September 10,

> 1965. The plan of liquidation was not adopted until May 14, 1966. But the destroyed property was insured, and the insurance claims were finally negotiated, settled and paid after May 14, 1966. The Court holds that the sale or exchange took place at the time of the fire; for in its view, it was the fire that transformed 'tangible property into a chose in action consisting of a claim for fire insurance proceeds....' Ante, p. 12.
>
> "I disagree. That the fire gave the company a claim under its insurance policies does not mean that the involuntary conversion qualifying as a sale or exchange took place at that moment. It is my view that such a claim does not ripen into a sale or exchange until it has attained a sufficiently definite quality and value to require the gain or loss to be accrued on the books of an accrual basis taxpayer. It is plain enough for me that no gain was accruable by Central Tablet until after May 14, 1967, and that the sale or exchange therefore took place after rather than before the adoption of the liquidation plan."
>
> (Emphasis supplied.)

Several conclusions, relevant to the present case, can be drawn from Central Tablet:

First, Flaccus is today thoroughly outmoded and discredited. See footnotes 5 and 6, 42 L.W. at page 4964.

Secondly, "sale or exchange" in today's Internal Revenue Code, e.g. in Section 337, is not to be narrowly confined to limitations supposedly established by the Flaccus case. The subsequent enactment of Sec. 117(j) of the 1939 Code, now Section 1231, has had a liberalizing and expansive effect generally on the

meaning of "sale or exchange" in today's Internal Revenue Code. The Supreme Court's citation and apparent approval in Central Tablet of Towanda Textiles, Inc. v. United States, 149 Ct. Cl. 123, 180 F. Supp. 373 (1960) and Kent Mfg. Corp. v. Commissioner, 288 F.2d 812 (C.A. 4, 1961) should be conclusive of the Supreme Court's approval today of a liberal and expansive reading of "sale or exchange". These two cases liberally interpret "sale or exchange" in Sec. 337 so as to include "involuntary conversion", a result directly contrary to Flaccus.

Thirdly, the former requisite of a "sale or exchange", viz. that there be a transfer of property to the payor of consideration, has in effect been reduced to a lesser requirement that the recipient of consideration has given up or lost an interest in property, for which the consideration is payment. To constitute a "sale or exchange" there is no longer any necessity for an acquisition of property by the payor; indeed in Central Tablet there was no acquisition of property by the payor of consideration, yet all nine Supreme Court judges concluded a "sale or exchange" had taken place at some time.

Fourth, the Tax Court's apparent attempt, in the instant case, to add a new requirement for a "sale or exchange", viz. that the seller must not only make a transfer of property

to the payor of consideration but must make it contemporaneous with his receipt of consideration, is contrary to the majority view of the Supreme Court. In Central Tablet the majority concluded that a "sale or exchange" occurred earlier at the time of the fire, although payment therefor did not then occur but a long time thereafter, at which payment time the recipient clearly made no transfer of property to the payor of consideration (the insurance company).[10]

Fifth, the term "sale or exchange" today embraces transactions that may not conform in all particulars to "true sales" or "normal sales". 42 L.W. at pp. 4964, 4965.

Applying to the instant case the language and reasoning of Central Tablet, either one of two conclusions must be reached: (1) a "sale or exchange" occurred "in pieces" when CBS appropriated Sirbo's theatre fixtures, etc. over the years (adapting to the instant case the majority view[10a] in Central Tablet); or (2) a "sale

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[10] Implicit in the dissenting opinion in Central Tablet is the assumption that a "sale or exchange" occurred when the insurance company made payment, or at least agreed to make payment, in some definite amount. Again, there was of course no transfer of property at that time to the payor of consideration (the insurance company).

[10a] Also the Commissioner's view in his Boston Fish Market brief.

or exchange" later occurred when Sirbo and CBS agreed on the $125,000 to be paid by CBS to Sirbo (adapting to the instant case the dissenting opinion in Central Tablet). Applying either theory, there was a "sale or exchange" under today's Internal Revenue Code.

VIII

The references in Section 1231 to "sales or exchanges" and "involuntary conversions" does not establish two wholly separate classifications, each calling for strict construction; considered overall, Section 1231 reflects a liberalized or expanded definition of "sale or exchange" that should not today be given a narrow or crabbed construction.

The Tax Court opinion treats "sales or exchanges" and "involuntary conversions" in Section 1231 as establishing two wholly separate classifications, to each of which presumably the Tax Court would attach a narrow or strict construction. Thus the Tax Court opinion states (S. R. 131, 132):

> "The appellate court agreed with our holding that there was no compulsory or involuntary conversion of property. However, that court remanded the case for reconsideration of our decision that the payment did not constitute an amount realized from the sale or exchange of property used in the trade or business within the meaning of section 1231."

* * *

> "It will be noted that the statute, by its very terms, recognizes that there may be a distinction between 'a sale or exchange' of property and 'the compulsory or involuntary conversion' of property."

The correct interpretation of Section 1231 is not to thus treat "involuntary conversions" as wholly separate and distinct from "sales or exchanges". There are at least three good reasons for viewing "involuntary conversions" as simply another liberalized or expanded form of "sales or exchanges".

First, although gains from "condemnations"--or even from transactions resulting from the mere threat or imminence thereof--are expressly treated by Section 1231 as gains from "compulsory or involuntary conversion", such gains are also clearly gains from "sales or exchanges". Rev. Rul. 59-108, 1959-1 C.B. 72. Hawaiian Gas Products, Ltd. v. Commissioner, 126 F.2d 4 (C.C.A. 9, 1942), cert. denied 317 U.S. 653; Commissioner v. Kieselbach, 127 F.2d 359 (C.A. 3, 1942).[11] In addition to "condemnations", other forms of "compulsory" conversions qualify as "sales or exchanges". Helvering v. Hammel, 311 U.S. 504 (1941); Electro-Chemical Engraving Co., Inc. v. Commissioner, 311 U.S. 513 (1941).

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[11] In Kieselbach, the Commissioner unsuccessfully relied on Flaccus in support of a narrow reading of "sale".

Second, both the Commissioner and the Tax Court once before unsuccessfully sought to create and enforce such an illusory dichotomy between "involuntary conversions" and "sales or exchanges". See Kent Manufacturing Corporation, 33 T.C. 930, at page 934 (1960), reversed by Kent Manufacturing Corporation v. Commissioner, 288 F.2d 812 (C.A. 4, 1961); and Towanda Textiles Inc. v. United States, 180 F. Supp. 373 (Ct. Cl. 1960). These two cases involved construction of "sale or exchange" in Section 392 and Section 337. Both the Fourth Circuit and the Court of Claims rejected a narrow construction of "sale or exchange" in those two sections (which narrow construction was initially favored by the Commissioner and the Tax Court) that excluded therefrom "involuntary conversion". The Commissioner thereafter reversed his former narrow reading of "sale or exchange", in favor of a liberal or more expanded meaning. Rev. Rul. 64-100, 1964-1 C.B. (Part 1) 130, revoking Rev. Rul. 56-372, C.B. 1956-2, 187 with its misplaced reliance on Flaccus.

Third, the Supreme Court in Central Tablet referred with apparent approval to Kent Manufacturing Corporation v. Commissioner, supra, and Towanda Textiles, Inc. v. United States, supra. In addition, the Supreme Court in that recent opinion treated a clear case of "involuntary conversion" as if it were a "sale or exchange".

The Tax Court opinion cites Chicago, Burlington & Quincy R. Co. v. United States, 455 F.2d 993 (Ct. Cl. 1972) pp. 1002-1004, reversed on another issue, 412 U.S. 401 (1973), to support the alleged dichotomy in Section 1231 of "sale or exchange" and "involuntary conversion". (S. R. 132) The rather obvious distinction in the Chicago, Burlington case, supra, and this case (and, incidentally, between Chicago, Burlington and Towanda Textiles, Inc. v. United States, 149 Ct. Cl. 123, 180 F. Supp. 373 (1960), and Kent Mfg. Co. v. Commissioner, 288 F.2d 812 (4th Cir., 1961) which construe "sale or exchange" for purposes of Section 337) is found in this language:[12]

> "....the purpose of §117(g)(3) (and later §1238) was to prevent taxpayers who are entitled to the benefits of rapid amortization of emergency facilities from later disposing voluntarily of those facilities so to convert accelerated amortization deductions from ordinary income into capital gains. ....involuntary conversions (unlike sales or exchanges) by their very nature are not events whose timing can be arranged to make inequitable gains after having had the benefits of rapid amortization." (Emphasis supplied.)

Thus for the purposes of Section 1238 "sale or exchange" was held to exclude involuntary conversions in order to avoid frustrating the Congressional purpose. The important thing to note about Section 1238 is that its purpose requires distinction between

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[12] 455 F.2d at page 1003.

voluntary and involuntary conversions and it provides different tax treatments for each, one treatment favorable to an affected taxpayer and the other unfavorable. Conversely, as noted above, Section 1231 provides the same kind of tax treatment to an affected taxpayer, whether there is a sale or exchange or an involuntary conversion. It follows clearly that Section 1231 does not require a distinction between voluntary and involuntary conversion. Moreover, whereas Section 1238 and its forerunner Section 117(g)(3) are limitary provisions, Section 1231 is a relief provision destined to give taxpayers the most favorable treatment, whether a transaction results in gain or loss.

Similarly, the Congressional purpose of Section 337 viz., to avoid double taxation on corporate liquidations, is not abused by affording like tax treatment to sales or exchanges and involuntary conversions. In fact, it can be said that the relief intended by Congress in enacting Sections 1231 and 337 would be frustrated by determinations that for the purposes of these sections "sale or exchange" and "involuntary conversion" are antithetical.

In any event, Chicago, Burlington does not illuminate the issue in the instant case. The holding is that Code Section 1238 is restricted to voluntary, taxable sales and exchanges and does not extend to involuntary conversions. There is no indication that

a transaction such as that involved here, which this Court has already held is not an involuntary conversion, is not a sale or exchange or its equivalent. If the tax treatment provided by Section 1231 were different for "sale or exchange" and "involuntary conversion", it could be argued that the answer in this case might lie in determining whether the transaction at issue is closer to "sale or exchange" or to "involuntary conversion". But, since Section 1231 applies the same tax treatment to either type of conversion, it should make no difference that the Sirbo transaction may lie somewhere between the two types of conversion.

IX

The Billy Rose case was wrongly decided.

In Billy Rose the taxpayer did not argue the applicability of Section 1231. (S. R. 17) Had it done so, a different result should have been reached.[12a]

The basis for a narrow or restrictive interpretation of "sale" in Section 453 rests largely on two cases, neither of

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[12a] This argument need not be considered by the Court of Appeals, if it has concluded that Billy Rose is not a precedent for disposing of the instant case. See pages 10-22 of this brief.

which considered the influence of Section 1231 on the meaning of "sale". These two cases are Charles J. Derbes, 24 B.T.A. 276, 283 (1931), aff'd 69 F.2d 788 (C.C.A. 5, 1934), which was in turn relied upon in Harry Leland Barnsley, 31 T.C. 1260 (1959). The Derbes case was decided in 1931, some eleven years before Section 117(j), now Section 1231, was first enacted into law.

If a "recognized gain" falls within the coverage of Section 1231, it no longer makes any difference, since the enactment in 1942 of Section 117(j) of the 1939 Code, that the gain results from a transaction which does not strictly qualify as a "sale". Since 1942, all "recognized gains" falling within this provision "shall be considered as gains . . . from sales or exchanges of capital assets held for more than six months". Section 1231(a).

In other words, the expanded definition of "sale" in Section 1231 has expanded the definition of "sale" in other sections of the Internal Revenue Code. Cf. Towanda Textiles, Inc. v. United States, supra, 149 Ct. Cl. 123, 180 F. Supp. 373 (1960) and Kent Mfg. Corp. v. Commissioner, supra, 288 F.2d 812 (C.A. 4, 1961).

X

The Billy Rose and Ferrer cases are not "compatible".

The Tax Court in its opinion found these two Second Circuit cases not incompatible. (S. R. 138). In support of this conclusion, the Tax Court relies on United States v. Dresser Industries, Inc., 324 F.2d 56 (C.A. 5, 1963) (S. R. 138).

This Dresser case is no support for the Tax Court's position. The Dresser case in fact interpreted Ferrer as a repudiation of a previous position of the Second Circuit, on which the Billy Rose case substantially rests. In Dresser the Fifth Circuit stated (324 F.2d 60):

> "Commissioner v. Starr Bros., Inc., 2 Cir 1953, 204 F.2d 67 which held that a release of an exclusive sales agency was not a sale or exchange, has been repudiated by the Second Circuit in Commissioner v. Ferrer, supra. We agree with the Second Circuit's disposition of the problem in Ferrer and adhere to the position taken by us in Ray."

The Billy Rose opinion, however, rests on an assumption of some continuing vitality for the Starr Bros., Inc. case. In Billy Rose the District Court concluded Starr Bros., Inc. possessed limited vitality on which it reached the result in Billy Rose. See page 20 of this brief.

XI

In any event, Section 1231 covers all "conversions", both "voluntary" and "involuntary", of property described in the section.

The method by which an asset described in Section 1231 is disposed of, whether "voluntary" or "involuntary", is not important because the section covers both forms of disposition and accords both the same kind of tax treatment.

In Burnet v. Harmel, 287 U.S. 103 (1932), long before the section now in question was enacted, the Supreme Court treated a "sale" of a capital asset as synonymous with a "conversion" into money of the owner's interest therein.[13] Thereafter some lower courts sought to limit the concept of "sale" to a "voluntary" transaction; the Supreme Court did not agree that such a limitation was justified in interpreting the provisions covering sale of a capital asset. Cf. Helvering v. Hammel, supra.

Congress, in 1942, enacted what is now Section 1231, and, we must assume, it was then aware of this prior judicial attempt on the part of some lower courts to limit "sale or exchange" (in the capital asset context) to a "voluntary" conversion of an owner's interest. Presumably it intended that a similar controversy should

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[13]See 287 U.S. at pages 106, 107, 108, 111.

not arise in interpreting this new provision. Congress was also doubtless aware of the Flaccus case, where the Supreme Court in 1941 had read into the concept of "sale or exchange" still another limitation, that Congress clearly did not agree with.

This broad language of Section 1231 and its legislative history furnish no basis today for limiting its coverage to certain kinds of disposition. That broad language was apparently enacted to avoid limitation of the section's coverage to certain forms of disposition, as some of the lower courts (see Helvering v. Hammel) and indeed the Supreme Court itself in Flaccus, had previously attempted to do in interpreting the capital gains provisions.

XII

The Tax Court's interpretation of Section 1231 leads to absurd results.

The Supreme Court has recognized that "sale" may have different meanings in different sections of the Internal Revenue Code. Helvering v. Hammel, supra.[14] It pointed out in that opinion also that interpretation of a tax statute should avoid absurd results, or results thwarting the obvious purpose of the statute. In this case it would lead to absurd results not to consider Sirbo's receipt of this $125,000 from CBS as entitled to capital gain treatment, under Section 1231. If we consider three situations, one of which is the instant case, it seems clear that all three should be entitled to the same capital gain treatment, under Section 1231, for lack of any meaningful difference.

Situation No. 1 (Hypothetical)

Assume that the lease, in lieu of an obligation to restore, had required CBS to pay Sirbo for any property that CBS removed or damaged. This would be a purely "voluntary ... sale or exchange", from the view of Sirbo, since it is agreeing in advance that the lessee CBS can take what it wants as long as it pays for it. Under

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[14] 311 U.S. at page 507.

the Second Circuit's opinion there is no doubt that Sirbo in this situation would be entitled to capital gain treatment, under Sec. 1231, for the Second Circuit stated (476 F.2d at page 987):

> ..."If the lease, in lieu of an obligation to restore, had obligated CBS from the outset to pay for the property to be removed or damaged by it, there could be little question but that the payment would be viewed as a sale or exchange of property used in the trade or business, see Hamilton & Main, Inc., 25 T.C. 878 (1956); Washington Fireproof Building Co., 31 B. T. A. 824 (1934), since the government does not contend that such a payment would represent 'collapsed income'. See e.g., Hort v. C. I. R., 313 U.S. 28 (1941) 61 S. Ct. 757, 85 L. Ed. 1168 (1941); Holt v. C. I. R., 303 F. 2d 687 (9 Cir. 1962); W. Lawrence Oliver, 24 T.C.M. 438 (1965). From a practical standpoint it is hard to see why the transaction here at issue should be treated differently. Classification of CBS's payment as ordinary income merely because of the parties' failure to cast the transaction at least partly in the form of a sale of the removed or damaged property would appear to exalt from over substance."

Situation No. 2 (Hypothetical)

Assume that the lease, in lieu of any reference to an obligation to restore, prohibited CBS from removing or damaging any of the leased premises (reasonable wear or tear excepted) but provided if CBS did so it would pay damages to Sirbo. This would

be a purely "involuntary conversion" from the view of Sirbo, but the proceeds would be entitled to capital gain treatment, under Section 1231, for the Second Circuit also stated (476 F.2d at page 986):

> "Grant Oil Tool Co. differs in a crucial respect. There the taxpayer could not have had restoration of the destroyed property,. . . . In that case a manufacturer leased oil well drilling tools to drillers for use in their business, subject to loss in the drill hole, misplacement, or damage beyond repair due to the driller's negligence in use. The decision to abandon or try to retrieve the tools lost in the drill hole was found to be exclusively that the driller-lessee, who was obligated in either event to reimburse the lessor at the sale price of new equipment. These payments were held to be entitled to capital gains treatment pursuant to §1231(a) as a 'compulsory or involuntary conversion', for the reason that the 'complete and unwanted destruction of [the] taxpayer's tool bodies' which brought it 'within the definition of 'involuntary conversion' as set forth in §1231(a),' id. at 395-96, was beyond the taxpayer's control once its property was leased. As far as the lessor was concerned the property destroyed in the lessee's operations was irretrievably lost without opportunity of restoration or recovery. See also Philadelphia Quartz Co. v. United States, 179 Ct. Cl. 191, 374 F. 2d 512 (1967)."

Situation No. 3 (Actual)

The instant situation is situation No. 3. It seems to fall somewhere between No. 1 and No. 2. It approaches the

"voluntary" situation in Situation No. 1 in that the lessor contemplates the lessee's possible or probable removal or destruction or modification of part of the leased premises. On the other hand it somewhat resembles the "involuntary" situation in Situation No. 2, in that the lessor reserves the right to have the premises restored to their original 1947 condition, or alternatively the lessor will become entitled to money compensation for any removed, destroyed, or damaged premises.

No matter which end of this tax spectrum is looked to (the purely "voluntary. . .sale or exchange" end of Situation No. 1, or the opposite purely "involuntary conversion" end of Situation No. 2), we find under the Second Circuit's prior opinion that the lessor would be entitled to capital gain treatment, under Section 1231. Since <u>both</u> extreme ends of this "voluntary-involuntary" tax spectrum contemplate capital gain treatment, under Section 1231, it is difficult to understand why a gradation falling between the two should not also be entitled to the same result, or why a rational Congress would intend a different result.

XIII

The Tax Court opinion attaches weight to a legally erroneous statement, and to other unsupported statements of fact.

The Tax Court opinion states (S. R. 135, 136):

> "The liability of the lessee encompassed not only the replacement of curtains, seats, and the like, which had long since been removed and presumably 'junked,' but also the removal of the walls, partitions, and other installations made by the lessee to convert the property to its use. To the extent that the obligation to restore related to the seats, carpets, curtains, and other property which had been removed by the lessee in the conversion of the theater, we are dealing with depreciable assets, the cost of which had long since been recovered by the petitioner through the composite depreciation claimed on the property as a whole. To the extent that the obligation related to the cost of removing walls, partitions, and wiring installed by the lessee, it was incumbent upon the petitioner to show that the modifications damaged its property in the economic sense. At this time there could be no proof of any damage or economic loss on account of the changes made by the lessee. As evidenced by the new lease, the value of the property was, if anything, enhanced."

The Tax Court's statement that the "depreciable assets" in question were wholly depreciated is legally irrelevant to the issue in this case.[15] Reg. §1.1231-1(c)(1) states:

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[15] In addition to being without any support in the record.

> "(c) Transactions to which section applies. Section 1231 applies to recognized gains and losses from the following:
>
> (1) The sale, exchange, or involuntary conversion of property held for more than 6 months and used in the taxpayer's trade or business, which is either real property or is of a character subject to the allowance for depreciation under section 167 (even though fully depreciated), *** "

Counsel for Sirbo cannot understand the mystifying statement that "it was incumbent upon the petitioner [Sirbo] to show that the modifications damaged its property in the economic sense". The Tax Court opinion cites no supporting authority. The only issue in question in this case is the taxable nature of an admitted gain. There can be no question, however, that both Sirbo and CBS did regard the latter's modifications to the leased premises as damaging Sirbo's property. The attention of the Court of Appeals is respectfully directed to the argument made in Sirbo's brief filed with the Tax Court after remand. (S. R. 126-128)

Also inexplicable is the Tax Court's statement (S. R. 136):

> "At this time there could be no proof of any damage or economic loss on account of the changes made by the lessee. As evidenced by the new lease, the value of the property was, if anything, enhanced."

There is not a scintilla of evidence in this record, either in the terms of the "new lease" or elsewhere, to show Sirbo's

property had been enhanced by CBS's modifications. The conduct of the parties is consistent only with their continuing realization that such modifications were damaging Sirbo's property. (S. R. 126-128) The fact that the rent increased over the period of CBS's occupancy, from 1947 to 1963, is hardly evidence that CBS's modifications improved the leased premises; there is scarcely a rent in this country that didn't increase over that same period, a tribute to persistent inflation.

XIV

The Tax Court failed to comply with the mandate of the Court of Appeals that it require the Commissioner "to explain and justify" his different positions in this case and in Boston Fish Market.

This argument has been set out in Sirbo's brief filed with the Tax Court after remand, to which the attention of the Court of Appeals is respectfully drawn. (S. R. 19, footnote 10; 114-121)

CONCLUSION

The Tax Court opinion and decision in this case should be reversed and remanded with directions that Sirbo be granted long-term capital gain treatment with respect to the income or gain element in the $125,000 payment by CBS, i.e., the excess of $125,000 over Sirbo's properly allocable "basis" for its property removed or damaged by CBS. (S. R. 19, footnote 9)

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that service of this Brief, and associated Appendix, was made on Respondent, Appellee on August 7, 1974, by mailing three copies thereof, postage prepaid, to its counsel at the following address, together with two copies of APPELLANT'S APPENDIX in related Docket No. 72-1617:

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